

AUDIT LIAISON GROUP

MEETING OF 28 FEBRUARY 2003

Those present:

Gus O'Donnell, Permanent Secretary HM Treasury
Sir John Bourn, Comptroller and Auditor General } Joint Chairs
John Gieve, Permanent Secretary Home Office
Tim Burr, Deputy Comptroller and Auditor General
Sir Andrew Likierman, Managing Director FMRA
HM Treasury
Robin Martin, Inland Revenue
Caroline Mawhood, Assistant Auditor General NAO
John Coombe, Finance Director GlaxoSmithKline
Mike Suffield, NAO
Chris Butler, HM Treasury
Rob Molan, HM Treasury } Joint Secretaries
David Corner, NAO

Introductions

Gus O'Donnell welcomed those present to the Treasury for the first meeting of the Group. Robin Martin reported he was substituting for Sir Nick Montagu who was unwell.

Terms of reference

It was **agreed** that the Group's terms of reference would be:

- to consider whether the arrangements set out in the Government's response to Lord Sharman's report Holding to Account are working effectively.
- to resolve issues relating to audit arrangements which cannot be resolved through normal operational channels.
- to consider the longer term development of the framework for audit and accountability across central government.

It was also **agreed** that minutes of the Group's meetings would be published on the Treasury and NAO websites

Implementing the undertakings on audit and access

Rob Molan introduced paper ALG03/2. He recalled that the Government had undertaken, in response to Lord Sharman's report, to give the Comptroller and Auditor General (C&AG) statutory responsibility for the audit of those executive Non Departmental

Public Bodies (NDPBs) where he did not already have this responsibility; and to give the C&AG a statutory right of access, for the purpose of his financial audit work, to relevant documents in the hands of grant recipients, contractors and sub-contractors. The Government was currently in the process of seeking Parliamentary approval of the Orders necessary to put these undertakings into effect.

Sir John Bourn said both he and the Public Accounts Committee had welcomed these undertakings. He understood that there had been some initial technical problems with the Orders but these were being remedied.

Initiatives by the NAO to enhance accountability

Caroline Mawhood introduced paper ALG03/3 and outlined the measures the NAO had taken to maintain and strengthen the confidence of audited bodies and other stakeholders in their work. These were:

- the nomination of a client liaison director, with overall responsibility for liaison between the National Audit Office and every client.
- the introduction of a central reference point, independent of audit teams, where clients may refer issues other than matters of audit judgement.
- the extension of the use of questionnaires for financial audit and VFM work giving clients the opportunity to express their views on the service provided.
- sharing with clients the results of external quality assurance exercises carried out, for financial audit, by the Joint Monitoring Unit of the Professional Institutes of Accountancy, and, for VFM examinations, by the London School of Economics.
- changes in the NAO's corporate governance arrangements

In discussion the following points were made:

- clients who filled in questionnaires on named basis might not be as candid in their comments as they would be in commenting to a third party collecting views. The Home Office sought views from their stakeholders directly and using mediated surveys. These processes yielded different results
- the NAO wanted Departments to be frank in their comments about the NAO's performance and to raise concerns directly with them
- 15-16% of the NAO's financial audit work was contracted out at present and this would rise to 25% by 2004-05, expressed in terms of the cost of work by private firms as a proportion of the total costs of the NAO's accounts certification work.
- the NAO contracted out one or two VFM studies per year but there had so far proved to be few suppliers who would undertake complete studies within NAO budgets. Up to 15% of the costs were however spent on consultants assisting study teams. The development of an external supplier base would increase the scope for contracting out such studies. In the medium to longer term a target might be set analogous to that for contracting out financial audits.
- there would be value in including an external member in each VFM study team carried out in-house, for example a secondee from the relevant Department.

- the costs to Departments of financial audits and VFM studies were significant and exposing these would enable both NAO and Departments to consider ways of alleviating them. The extent of cooperation from Departments also affected the NAO's own costs.
- the media coverage of NAO reports was a matter of concern to Departments. The ALG could usefully discuss this at a future meeting.
- the messages conveyed to Departments by their auditors did not always coincide with the terms of the audit certificate. This may however be a transitional problem.
- it would be worth drawing out the general lessons from VFM studies and the implications these had for the conduct of future studies
- in cases where Departments' accounts were consolidated with other bodies, the procedures and standards applied by the audit bodies involved were sometimes different.

Summing up, Gus O'Donnell thanked the NAO for their paper, and identified the following **conclusions and action points** from the discussion:

- the NAO would identify ways of **seeking the views of clients via a mediated survey**, as well as through direct written and face to face contact; and would report back on their conclusions at the next meeting.
- the NAO would consider how to **contract out more VFM study work and whether a target should be set** and how this should be measured; and would report back on their conclusions at the next meeting.
- the Treasury would encourage Departments **to offer to second people to the NAO to work on VFM studies**
- the NAO and Departments should **exchange information on the costs incurred by both parties in the course of financial audits and VFM studies**. The Treasury would ask Departments to do this as a matter of course.
- **press coverage** of NAO reports should be discussed at a future meeting
- the NAO would **reinforce their "no surprises" policy in their financial audit work** and identify possible ways of harmonizing procedures and standards with other audit bodies where there were boundary considerations.

Risk management and statements on internal control

Mike Suffield introduced the NAO paper ALG03/4. The results of the NAO's review were consistent with those coming out of the Treasury's survey. These indicated that good progress has been made by the majority of departments, but much still needed to be done by some if they were to achieve full and functioning systems of risk management. The NAO was keen to make progress on the difficult issue of assessing the effectiveness of internal controls and the pilots they were undertaking should assist here.

Chris Butler introduced the Treasury paper ALG03/5. Some findings of the Treasury survey might under-estimate the amount of work which Departments still had to do. For example, 14% of respondents reported they did not expect to have all risk management

processes in place by the end of financial year 2002/3, but 19% reported they did not have an action plan to develop risk management processes. There was need for more Departments to produce SICs which provided a meaningful portrayal of the organisation's own processes. In developing its plans for the next phase of SICs, the Treasury was taking care to integrate this work into the wider programme taking forward the PIU report on risk.

In discussion the following points were made:

- Departments must see risk analysis as being integral to their business and not a separate process
- a pro forma SIC could not capture the full extent of some Departments' activities. The revised guidance would need to identify means of encouraging more tailor made documents.
- the challenge faced by some Departments in making the cultural changes necessary to embed risk management techniques should not be under-estimated. The range of risks they faced meant that they had to prioritise actions to manage them. Some risks were beyond the control of Departments and the boundary they were expected to observe needed to be clear.
- the private sector faced a similar challenge to the public sector in ensuring that managers addressed business risks and reported upwards on them
- there was a strong case for SICs being discussed at board level in Departments, rather than leaving it a matter for the Accounting Officer to consider. This would enable non-executive Directors to comment on the risks faced by the organization.
- there might be a case for going further and requiring all Board members to sign the SIC. The US Sarbanes Oxley legislation was pushing some private sector firms in that direction
- the NAO could assist progress by recognising well managed risk. This would incentivise Departments to be less risk averse when taking forward challenging projects or programmes

Summing up, Gus O'Donnell thanked the NAO and Treasury for their papers, and identified the following **conclusions and action points** from the discussion:

- the Treasury would **update the guidance to Departments on SICs** in a manner which encouraged a transparent picture of their internal control systems to be provided; and report back on the outcome at the next meeting
- in preparing that guidance, the Treasury would consider in consultation with the NAO **how boards should be given a role in the scrutiny and approval of SICs**
- the Treasury would include details of enhancements to the SIC process and their links with **the Strategy Unit risk report follow up programme in a future report to the Prime Minister.**
- the NAO would continue to look for opportunities **to identify examples of well managed risk taking**

- the NAO would explore with the Treasury options for **making progress on the issue of assessing the effectiveness of controls**, including by taking forward the pilot work testing out methodologies and model reports as a basis for future work.

Future work programme

Rob Molan introduced paper ALG03/6. The Group would want to come back to some of the issues discussed at this meeting . Five additional items might be taken at future meetings:

- faster closing of accounts: what more should be done to enable the faster closing of accounts and hence the publication of more timely and relevant financial information?
- NAO VFM studies: a strategic look at the shape and coverage of the VFM study programme would be opportune, given it would be growing in size,
- feedback on the NAO's work: The Group might review the emerging conclusions from the LSE reviews of NAO VFM reports, the JMU scrutiny of its financial audit work and feedback from Departments.
- financial expertise in Departments: the opportunities provided by RAB would only be fully seized if Departments employed enough people with the right skills. The Group might discuss the progress Departments were making in this respect.
- excess votes: there had been an increase in the number of Departments incurring expenditure in excess of the limits voted in the Supply Estimates. What steps should be taken to redress this?

In discussion, the following points were made on these additional items:

- the number of excess Votes may be a transitional problem. Guidance had been issued to Departments and it would be better to wait and see whether the issue persisted next year before deciding whether to bring it to the Group.
- faster closing should be discussed as the potential for progress was considerable. For example, Australia was seeking to bring closure down from four months to three, and was now discussing a move to 45 days; compared with between three and ten months in the UK.
- a study was underway in the Treasury on the skills issue. It would be helpful if the NAO could clarify their view as to what the required level of skills should be in Departments.
- there may be a case for taking faster closing and skills in Departments as a single agenda item.
- the suggested items on the VFM work programme and feedback on the NAO's work fitted with the earlier discussion on NAO accountability.

Summing up, Gus O'Donnell thanked the Treasury for their paper. Faster closing, VFM studies, financial expertise and feedback on the NAO's work should be included in the future work programme, as should media coverage of NAO reports.

Any other business

It was agreed that the next meeting of the Group would take place in September at the NAO.

HM TREASURY
25 March 2003